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Ketua Pengarah Hasil Dalam Negeri v Penang Realty Sdn Bhd and another appeal

B COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEALS NO W–01–10 OF 1997 AND NO W–01–11 OF 1997
MOKHTAR SIDIN, PS GILL AND RAHMAH HUSSAIN JJCA
20 APRIL 2006

C *Revenue Law — Income tax — Capital versus income — Housing developer built houses on land for rental — Whether land was stock in trade and transient in nature — Whether profits made from subsequent disposal of houses were capital appreciation*

D *Revenue Law — Income tax — Capital versus income — Profit from compulsory acquisition of land by Government — Whether compulsion vitiated intention to trade — Whether subject to income tax*

E The taxpayer was a company carrying on business of housing developments and other businesses relating to realties. In 1956, the taxpayer purchased the subject land. From 1956 to 1980, portions of the subject land in their undeveloped state were regularly sold by the taxpayer. It was not disputed that the taxpayer paid income tax on profits made from those sales. The taxpayer then embarked on building houses on the land which were built in three phases; these houses were rented out until 1981. F From 1981 to 1984, the taxpayer succeeded in selling 88 units of houses. It was also not disputed that the taxpayer made profits from the sale of those houses. The Revenue then assessed the taxpayer on the profits made. The taxpayer disputed the assessments claiming that the profits were not taxable because those houses were built for the purpose of investments and the profits made from the sale were capital G appreciation.

A portion of another subject land, also purchased by the taxpayer in 1956, was compulsorily acquired by the Government in August 1980. In May 1982, the taxpayer was paid the sum of RM1,035,762.91 as compensation. The Revenue sought to tax the compensation and accordingly assessed that sum. Learned counsel H for the appellant submitted that since the land was compulsorily acquired, the question of the appellant trading in the land did not arise.

The Special Commissioners held that: (1) the profit arising from the disposal of the houses was profit from its business activities; and (2) the compensation received by the appellant in respect of the acquired portion of the land paid by the Collector of I Land Revenue was also profit from its business activities. The taxpayer appealed to the High Court. The learned judge who heard the appeal dismissed the appeal in respect of the first order and affirmed the order of the Special Commissioners whereby the profit arising from the disposal of the houses was profit from the taxpayer's business activities. Being dissatisfied with the decision of the learned judge, the Revenue appealed against the order of the learned judge allowing the appeal by

the taxpayer in respect of the compensation. The taxpayer also, being dissatisfied with the decision of the learned judge dismissing their appeal in respect of the disposal of the houses, appealed to this court.

Held, dismissing both appeals:

(1) The compulsory acquisition by the Government of the appellant's land in the instant case could not constitute a sale the proceeds of which were subject to tax because the element of compulsion vitiated the intention to trade. In the circumstances, that part of the order of the Special Commissioners that the profits derived from the compensation paid to the appellant on account of the compulsory acquisition of part of the land was profits arising out of the appellant's business activity could not be sustained (see para 12). In this respect, the learned judge had dealt with the issue of compensation exhaustively. The learned judge had stated the evidence and applied the law correctly and there was nothing much this court could add to what had been said by him (see para 13).

(2) The subject land on which the houses stood was not the appellant's capital asset. The appellant did not intend to invest its savings in the subject land and got income from the land or the structures put up on the land so as to make the subject land its capital asset. The subject land remained its stock-in-trade and the houses were constructed on it purely to snap on the advantageous position of the rental to be paid by the RAAF and when the purpose was no longer served, the houses together with the acres of land on which they stood were disposed off. So, the houses with which it dealt could not in the circumstances be regarded as the appellant's capital asset, they being transient in nature. In the circumstances, on the facts found and stated by the Special Commissioners, their decision to dismiss the appeal of the appellant in relation to the issue of the sale of the 88 units of houses built by the appellant on the subject land was correct in law (see para 18). In this respect also, the learned judge had stated the issue in respect of the sale of the 88 units of houses correctly. He had analysed the facts in the present appeal in the most appropriate manner and correctly (see para 19).

[Bahasa Malaysia summary

Pembayar cukai merupakan sebuah syarikat yang menjalankan urusan pembangunan perumahan dan lain-lain urusan berkaitan harta tanah. Pada tahun 1956, pembayar cukai tersebut telah membeli tanah subjek. Daripada tahun 1956 hingga 1980, beberapa bahagian daripada tanah tersebut dalam keadaan yang tidak dimajukan lagi telah dijual oleh pembayar cukai. Ia tidak dipertikaikan bahawa pembayar cukai itu telah membayar cukai pendapatan berdasarkan keuntungan yang dibuat daripada jualan-jualan tersebut. Pembayar cukai kemudian telah memulakan pembangunan rumah-rumah atas tanah tersebut yang telah dibina dalam tiga fasa, rumah-rumah tersebut telah disewa sehingga tahun 1981. Daripada tahun 1981 hingga 1984, pembayar cukai telah berjaya menjual 88 unit rumah. KPHDN kemudian telah menaksir pembayar cukai berdasarkan keuntungan yang dibuat. Pembayar cukai

telah mempertikaikan penaksiran tersebut dengan mendakwa bahawa keuntungan tidak perlu dikenakan cukai kerana rumah-rumah tersebut telah dibina bagi tujuan pelaburan dan keuntungan yang dibuat daripada jualan merupakan pulangan modal.

Sebahagian daripada tanah lain, juga dibeli oleh pembayar cukai pada tahun 1956, telah diperoleh secara wajib oleh Kerajaan dalam bulan Ogos 1980. Dalam bulan Mei 1982, pembayar cukai telah membayar sejumlah RM1,035,762.91 sebagai pampasan. KPHDN telah mengenakan cukai ke atas pampasan itu dan berikutnya menaksir jumlah tersebut. Peguam bijaksana bagi pihak perayu berhujah bahawa memandangkan tanah tersebut telah diperoleh secara wajib, persoalan perayu berniagakan tanah tersebut tidak timbul.

Pesuruhjaya Khas telah memutuskan bahawa: (1) keuntungan yang timbul daripada jualan rumah-rumah tersebut merupakan keuntungan daripada urusan perniagaannya; dan (2) pampasan yang diterima daripada perayu berhubung bahagian yang diperoleh ke atas tanah yang dibayar oleh Pemungut Hasil Tanah merupakan keuntungan daripada urusan perniagaannya. Pembayar cukai telah merayu ke Mahkamah Tinggi. Hakim bijaksana yang mendengar rayuan telah menolak rayuan tersebut berkaitan perintah pertama dan mengesahkan perintah Pesuruhjaya Khas di mana keuntungan yang timbul daripada jualan rumah-rumah itu adalah keuntungan daripada urusan perniagaan pembayar cukai. Berasa tidak puas hati dengan keputusan hakim bijaksana itu, KPHDN telah merayu terhadap perintah hakim bijaksana yang membenarkan rayuan oleh pembayar cukai berkaitan pampasan. Pembayar cukai juga, yang berasa tidak puas hati dengan keputusan hakim bijaksana menolak rayuan mereka berkaitan jualan rumah-rumah tersebut, telah merayu kepada mahkamah ini.

Diputuskan, menolak kedua-dua rayuan tersebut:

(1) Pemerolehan wajib oleh Kerajaan berhubung tanah perayu dalam kes semasa tidak boleh membentuk satu jualan hasil yang tertakluk kepada cukai kerana elemen pemaksaan menjadikan niat berniaga tidak sah. Dalam keadaan ini, bahagian perintah Pesuruhjaya Khas bahawa keuntungan itu datang diperoleh pampasan yang dibayar kepada perayu untuk pemerolehan wajib bahagian tanah itu adalah keuntungan yang timbul daripada urusan perniagaan perayu itu tidak boleh dikekalkan (lihat perenggan 12). Sehubungan itu, hakim bijaksana telah menyatakan keterangan tersebut dan menggunakan undang-undang dengan betul dan tiada apa yang mahkamah boleh tambah kepada apa yang telah dikatakan olehnya (lihat perenggan 13).

(2) Tanah tersebut di mana rumah-rumah dibina bukanlah modal aset perayu. Perayu tidak berniat untuk melabur simpanannya dalam tanah tersebut dan mendapat pendapatan daripada tanah itu atau struktur-struktur yang dibina atas tanah itu untuk menjadikan tanah tersebut modal asetnya. Tanah tersebut mengekalkan stok dalam perdagangannya dan rumah-rumah yang dibina atasnya adalah untuk mendapat keuntungan daripada sewa yang dibayar oleh RAAF dan apabila tujuan itu tidak diperlukan lagi, rumah-rumah tersebut bersama tanah tersebut dijual. Oleh itu, rumah-rumah yang dikendalikannya tidak mungkin dalam keadaan sedemikian dianggap sebagai modal aset perayu, yang hanya bersifat sementara. Dalam keadaan sedemikian, berdasarkan fakta

yang diperoleh dan dinyatakan oleh Pesuruhjaya Khas, keputusan mereka untuk menolak rayuan perayu berkaitan persoalan jualan 88 unit rumah yang dibina oleh perayu atas tanah tersebut adalah sah di sisi undang-undang (lihat perenggan 18). Sehubungan itu juga, hakim yang bijaksana telah menyatakan bahawa persoalan berkaitan jualan 88 unit rumah itu dengan betul. Beliau telah menganalisis fakta-fakta dalam rayuan semasa dengan betul dan cara yang sesuai (lihat perenggan 19).]

Notes

For cases on capital versus income, see 10 *Mallal's Digest* (4th Ed, 2002 Reissue) paras 2121–2123.

Cases referred to

Lim Foo Yong Sdn Bhd v Comptroller General of Inland Revenue [1986] 2 MLJ 161 (refd)

Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri [1994] 2 MLJ 713 (refd)

West v Phillips [1956-1960] 38 TC 203 (refd)

Legislation referred to

Income Tax Act 1967 s 2

Appeal from: Appeal No R1-14-10 of 1995 (High Court, Kuala Lumpur)

DP Naban (Nitin Nadkarni with him) (Lee Hishamuddin) for the appellant in Civil Appeal No W-01-11 of 1997/respondent in Civil Appeal No W-01-10 of 1997.

Abu Tariq Jamaludin (Hazlina Husin, Muazmir Mohd Yusof and Ahmad Ishak Hassan with him) (Inland Revenure Board) for the respondent in Civil Appeal No W-01-11 of 1997/appellant in Civil Appeal No W-01-10 of 1997.

Mokhtar Sidin JCA (delivering judgment of the court):

[1] Arising from the majority decision of the Special Commissioners the taxpayer appealed by way of case stated to the High Court. The majority decision of the Special Commissioners are as follows:

ADALAH DIPUTUSKAN BAHAWA keuntungan daripada pelupusan-pelupusan harta itu adalah merupakan keuntungan daripada aktiviti perniagaan.

ADALAH DIPUTUSKAN SELANJUTNYA BAHAWA pampasan yang diterima oleh pihak Perayu berkaitan dengan pengambilan sebahagian daripada Lot 2833 Daerah Timur Laut Pulau Pinang oleh Pemungut Hasil Tanah Daerah tersebut itu adalah juga merupakan keuntungan daripada aktiviti perniagaan.

[It is decided that the profit arising from the disposal of the houses is profit from its business activities.

It is further decided that the compensation received by the appellant in respect of the acquired portion of Lot 2833 North East District Penang paid by the Collector of Land Revenue is also profit from its business activities.]

[2] The learned judge who heard the appeal dismissed the appeal in respect of the first order and affirmed the order of the Special Commissioners whereby the profit arising from the disposal of the houses was profit from the taxpayer's business activities. In respect of the second order the learned judge allowed the appeal by the taxpayer and held that the compensation was not taxable.

[3] Being dissatisfied with the decision of the learned judge, the Revenue appealed against the order of the learned judge allowing the appeal by the taxpayer in respect of the compensation. The taxpayer also, being dissatisfied with the decision of the learned judge dismissing their appeal in respect of the disposal of the houses, appealed to this court.

[4] Thus, there are two appeals in this case. The first appeal, No W–01–10 of 1997 is the appeal by the Ketua Pengarah Hasil Dalam Negeri ('the Revenue') against the decision of the learned judge who allowed the appeal by the taxpayer that the compensation paid by the Government for the compulsory acquisition of a piece of the taxpayer's land be vacated. We have dismissed this appeal with costs after hearing the submissions of the parties. We now give our reasons for doing so.

[5] The second appeal, No W–01–11 of 1997, is the appeal by the taxpayer against the decision of the learned judge who had affirmed the decision of the Special Commissioners that the profit made by the taxpayer on the disposal of 88 units of houses was assessable to tax. We have reserved judgment on this appeal and now we give our reasons and decision in respect of the second appeal.

FACTS

[6] The taxpayer was incorporated on 5 July 1956. Amongst its objects are:

(a) to acquire by purchase, lease, exchange, hire or otherwise by way of investment or with a view to resale or otherwise any lands and hereditaments of any tenure or any other form of real or personal property, rights or privileges or any interest in the same or in any mortgages, shares and securities; to sell, lease, let, mortgage or otherwise dispose of the lands, houses, buildings, hereditaments and other property of the Company; to develop and turn to account any land acquired by the Company or in which the Company is interested and in particular by laying out and preparing the same for building purposes, constructing, altering, pulling down, docorating, maintaining, furnishing, fitting up and improving buildings and by planting, paving, draining, farming, cultivating, letting on building lease or building agreement and by advancing money to and entering into contracts and arrangements of all kinds with builders, tenants and others;

(b) to carry on the business of house agents and also all or any of the following businesses, namely builders and contractors, decorators, merchants, and dealers in stores, sand, lime, bricks, timber, hardware and other building requisites;

(c) to enter into agreements for letting houses, buildings, furniture, fittings to any person, company or authority and to collect rents, interest and other moneys in connection with any such property;

(d) to improve, manage, develop, exchange, let on lease, sub-lease, sell or otherwise dispose of or turn to account or deal with all or any of the property and rights of the Company;

(e) to buy, sell, manage, develop and exploit immovable property generally of all kinds, rubber and other plantations and estates, and tin or other mineral mines and properties and to do all such things pertaining thereto or necessary or desirable to turn the same to account;

(f) to sell or otherwise dispose of the whole or any part of the undertaking of the Company either together or in portion, for such consideration as the Company may think fit.

From the above, it is not disputed that the taxpayer is a company carrying on business of housing developments and other businesses relating to realties.

[7] In 1956, the taxpayer purchased the subject land. At the board of directors meeting held on 4 December 1956 the managing director reported on the deposits received in respect of the sale by the taxpayer of Lots 2(33) and 2(34) Mukim 18, North East District, Penang. At the board of directors meeting held on 13 March 1958, the board approved the sale of Lots 330, 681, 686 and parts of Lot 243. From 1956 to 1980, portions of the subject land in their undeveloped state were regularly sold by the taxpayer. It was not disputed that the taxpayer paid income tax on profits made from those sales.

[8] At a board of directors meeting held on 30 December 1963, the board passed the following resolution:

> The Directors unanimously approved that houses be built from time to time for renting out to the Australian Army.

[9] The income from the rental would be high and it was a profitable business. The taxpayer then embarked on building houses which were built in three phases. The taxpayer began constructing the houses in Phase I sometime in 1967 whereby a total of 82 units of houses were built on the subject land. Out of the 82 units of houses built, 75 of them were rented out to the Royal Australian Air Force (RAAF), the balance were rejected by the RAAF. As a result of the rejection the seven units of houses were sold. Income tax were paid by the taxpayer on the profits made from the sale. In 1974 which was Phase II, another 14 units of houses were built and all of them were rented out to the RAAF making the total units rented out by the taxpayer to the RAAF to 89 units of houses. Between 1982 and 1985 which was Phase III, the taxpayer built another 166 units. The RAAF decided to rent the new units and all their personnel who were occupying the 89 units in Phase I and Phase II moved to the new units. The 89 units of houses were then left unoccupied and the taxpayer decided to sell them. From 1981 to 1984 the taxpayer succeeded in selling 88 units of houses, which in accordance with the years are as follows:

1981 — 62 units of houses

1982 — 16 units of houses

A 1983 — 9 units of houses

1984 — 1 unit of house

B **[10]** It was not disputed that the taxpayer made profits from the sale of those houses. The Revenue then assessed the taxpayer on the profits made. The taxpayer disputed the assessments claiming that the profits were not taxable because those houses were built for the purpose of investments and the profits made from the sale were capital appreciation. This is the essence of the second appeal.

C **[11]** In respect of the first appeal, in 1956 the taxpayer bought two pieces of land namely, Heintze Estate in Penang and Heintze Estate in Perak. The evidence shows that a portion of the subject land, Lot 2833, Bandar Tanjong Bongah, was compulsorily acquired by the Government in August 1980. The area acquired was 121,204.61 sq ft. In May 1982, the taxpayer was paid the sum of RM1,035,762.91 as compensation. The Revenue sought to tax the said compensation and accordingly assessed that sum.

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[12] The taxpayer being unhappy with both assessments appealed to the Special Commissioners. After hearing the appeal the Special Commissioners dismissed the appeal by the taxpayer in respect of both assessments. Being unhappy with the decision of the Special Commissioners, the taxpayer appealed to the High Court. The learned judge allowed the taxpayer's appeal against the compensation but dismissed the appeal against the disposal of the houses. In respect of the appeal against the compensation the learned judge said:

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> I now come to deal with the appeal concerning the tax levied by the respondent out of the compensation money received by the appellant on account of the acquisition of its property by the Penang State Government. The submission of the learned counsel for the appellant before me was brief in that since the land was compulsorily acquired the question of the appellant trading in the land does not arise. The appellant did not sell the land acquired by way of business. It was forcibly acquired from it and compensation paid. The learned counsel considers it to be unfair for the Government to forcibly acquire the appellant's land and then take back 30% of the compensation as trading profit. He relies on *Lower Perak Co-operative Housing Society Bhd v Ketua Pengarah Hasil Dalam Negeri* [1994] 2 MLJ 713 (SC) in support of the contention that no tax is leviable on the profits made on account of the compulsory acquisition of the appellant's property. In that case, there was a forced sale of the property by the taxpayer to the developer because the lots meant to be sold to the taxpayer's members were not taken up by the members. The taxpayer had no choice but to sell to the developer in view of the predicament in which it found itself and the inability of the taxpayer to raise funds from banks or financial institutions to finance its housing project of which the beneficiaries were its members. The Special Commissioners found that although the taxpayer had to sell the lots concerned to the developer, this merely indicated 'a change of customers' which was of 'no importance for it did not change the colour of the transactions which constituted trading in land within the meaning of s 4(a) of the Income Tax Act'. The appeal by the taxpayer to the Special Commissioners was dismissed and its further appeal to the High Court by way of case stated was similarly dismissed. Against the decision of the High Court, the taxpayer appealed to the then Supreme Court. Edgar Joseph Jr SCJ delivering the judgment of the Supreme Court said at p 749:
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> > The finding of the special commissioners that 'there was *some element of 'forced' selling* of the subject lots', and the further finding *that 'the object of the appellant* (the taxpayer) in

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> acquiring the land was to develop it and sell the lots to its members but because of *circumstances beyond* its control it could not sell all the lots to its members and hence had to sell the subject lots in dispute to a non-member, ie the developer', were findings which were amply justified by the evidence.
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> Unfortunately, however, the special commissioners failed to recognize *the significance* of these findings in the context of the taxpayer's contention that a forced sale cannot constitute a sale the proceeds of which are subject to tax because the element of compulsion vitiates the intention of trade. Indeed, nowhere in their case stated did they direct their attention to the question of intention of trade but instead adopted the over-simplistic approach that although the taxpayer had to sell the lots concerned to the developer, this merely indicated 'a change of customers' which was of 'no importance for it did not change the colour of the transactions which constituted trading in land within the meaning of s 4(a) of the Act'. Clearly, therefore, the special commissioners overlooked the salutary words of Lord Wilberforce in *Simmons v IRC* at p 800e that 'trading required an intention to trade' and that, therefore, the state of mind of those in control of the taxpayer and their motives were most material.
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> It is manifestly clear that the dominant purpose and also the dominant motive of the taxpayer was not to make a profit out of the transactions with the developer but to provide a roof over the heads of its members, and so, the resulting profit could not have been derived from a trading transaction or an adventure in the nature of trade but was an accretion to capital not liable to tax.
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> (Emphasis added.)

The Special Commissioners in the instant case found as a fact that a piece of land belonging to the appellant was compulsorily acquired. However, distinguishing *IRC v Fleming and Co (Machinery) Ltd 33 TC 57* , the Special Commissioners held that the acquisition of the piece of land was just like the sale of any other piece of land by the appellant. Therefore, the compensation received is the receipt of a payment from the Government in lieu of a receipt from an ordinary purchaser which would have formed part of the appellant's trading profit and the sum received will be taxable as income, citing *F Housing Sdn Bhd v Director General of Inland Revenue* [1976] 2 MLJ 183 as the authority for so holding. In that case at p 186 Mohamed Azmi J (as he then was) said:

> I would, therefore, agree with the submission of learned counsel for the respondent that the fact that the compulsory purchase is an isolated transaction does not really matter since there is sufficient evidence that the transaction is a trading transaction or best indicia of trade. As stated earlier on, the appellant company knew fully well that the land in question was to be acquired by the Government even before they bought it. The five vendors who ultimately became the first directors of the appellant company, must have known that, if they did not sell the land to the company, their individual task of convincing the collector that the rubber land was ripe for immediate development and therefore should attract much higher market value than the purchase would be more difficult. On the fact of the present case, I am therefore of the view that this isolated transaction, although it concerns compulsory acquisition, should lawfully be regarded as a trading transaction and as such, I hold that the difference between the acquisition award and the purchase price and cost of the land is income in respect of gains or profits from a business within the meaning of section 4(a) of the Income Tax Act 1967.

Reliance was also placed by the Special Commissioners on *London and Thames Haven Oil Wharves v Aftwooll* [1967] 2 All ER 124 and *IRC v Newcastle Breweries Ltd 12 TC 927* and came to the conclusion that if the piece of the appellant's land had been sold to an ordinary purchaser the payment made by the purchaser would have been treated as a trading receipt

by the appellant. Therefore, the fact that the sum paid by the Government through a different route does not alter the position in any way. Having considered the reasons for the findings of the Special Commissioners and the submissions made by the learned counsel, I am of the view that *F Housing Sdn Bhd* can easily be distinguished on its own facts and in the light of the clear authority of *Lower Perak Co-operative Housing Society Bhd*, the Special Commissioners had misdirected themselves by so holding. The compulsory acquisition by the Government of the appellant's land in the instant case cannot constitute a sale the proceeds of which are subject to tax because the element of compulsion vitiates the intention to trade. In the circumstances, that part of the order of the Special Commissioners that the profits derived from the compensation paid to the appellant on account of the compulsory acquisition of part of Lot 2833 North East District Penang are profits arising out of the appellant's business activity cannot sustain. I would therefore, allow the appeal by the appellant on this aspect of the assessment of tax by the respondent.

[13] I have cited the above passages from the judgment of the learned judge to show that he had dealt with the issue of compensation exhaustively. The learned judge had stated the evidence and applied the law correctly and there is nothing much I could add to what had been said by him.

[14] For the above reasons, we could not see any merit in the submissions of the Revenue and at the close of the submissions we have unanimously dismissed the appeal with costs.

[15] Turning to the second appeal by the taxpayer, that is the appeal in respect of the disposal of the 88 units of houses, it was the contention of the taxpayer that the houses were built for rental. The evidence shows that those houses, soon after being built, were let out to the RAAF. The RAAF rented out those houses for 17 years when they moved to the new houses built by the taxpayer. The taxpayer submitted that they decided to sell the houses which the taxpayer claimed to be their stock in trade and the taxpayer then cited the definition of 'stock in trade' in s 2 of the Income Tax Act 1967 ('the Act') which reads:

> 'stock in trade', in relation to a business, means property of any description, whether movable or immovable, being either —
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> (a) property such as is sold in the ordinary course of the business or would be so sold if it were mature or if its manufacture, preparation or construction were complete; or
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> (b) materials such as are used in the manufacture, preparation or construction of any such property as is referred to in paragraph (a) of this definition,
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> and includes any work in progress;

[16] The taxpayer contended that the Special Commissioners' finding of primary fact, the taxpayer had built those houses, not for sale, but specifically for the purposes of rental to the RAAF and all the 88 houses had been rented out to the RAAF for 17 years. That being the case, the only logical inference is that the 88 houses do not fall within the definition of 'stock in trade'. Those houses could only come within that definition if the taxpayer were in the business of building houses, like a housing developer, for the purpose of selling them. A person who builds houses only for rental cannot be said to be dealing with houses. Since those houses were not the taxpayer's

stock in trade within the definition of s 2 of the Act, their sale would not be subject to income tax. The assessments raised by the Revenue on the profits arising from the sale of those houses were clearly wrong. A

[17] The taxpayer further submitted that another test to decide whether those houses were disposed of in the ordinary course of their business or realisation of investment assets was to examine whether the disposal falls within the badges of trade which are: B

(1) *The dominant purpose for which the houses were built*: This is the focal point of the enquiry. The Special Commissioners found as a primary fact that the dominant purpose of building those houses by the taxpayer was to rent them out. The Special Commissioners were unduly influenced by the fact that the taxpayer had also traded in undeveloped land. The taxpayer contended the Special Commissioners in the present appeal made the same mistake as the Special Commissioners in *Lim Foo Yong Sdn Bhd v Comptroller General of Inland Revenue* [1986] 2 MLJ 161 in that just because the taxpayer traded in undeveloped property, they could not have held other developed property as an investment. The taxpayer submitted that once the Special Commissioners had accepted that the 88 houses were built for rental, the Special Commissioners had no alternative but to find that those houses were for investments. C D

(2) *Subject matter of the transaction*: If the houses which were the subject matter of the transaction generate no income, it would be an indication that they were held for trading, while on the other hand, the assets (the houses) generated substantial income, that would be an indicattion that they were capital assets. In the present appeal, the 88 houses, before they were sold, were income producing assets in the form of rentals. The finding of primary fact by the Special Commissioners shows that for the years 1967 to 1981 the largest share of the taxpayer's income came from rentals. E F

(3) *Period of ownership*: The taxpayer also submitted that the period of ownership is also an indication, i.e. the longer the assets were held by the taxpayer, the more likely they were for investment. Those houses, as found by the Special Commissioners, were held by the taxpayer for 17 years before they were sold, was a strong indication that they were for investments. G

(4) *Frequency of transaction in same kind of property*: The evidence is that from 1968 until 1981, there were no transactions by the taxpayer in similar property. The taxpayer submitted that the sale of the undeveloped land which produced no income was not of the same nature as transaction of the sale of income producing houses. H

(5) *Alteration of property to make it more saleable*: Evidence was led by the taxpayer that nothing was done by them to make the houses more saleable. The taxpayer submitted that this evidence which was in favour of the taxpayer was not considered by the majority of the Special Commissioners and the learned judge, and this amounts to a misdirection. I

(6) *Methods employed for sale*: There was no suggestion by the Revenue that there was no evidence before the Special Commissioners that the taxpayer had set up

any special organisation or had made special efforts to sell those houses such as setting up a showroom or advertising the sale of those houses.

(7) *Circumstances responsible for the sale*: The Special Commissioners found as a fact that the taxpayer sold the 88 houses because the RAAF do not wish to rent those houses any longer. It was not disputed that those houses could be rented out to the locals, but the rentals would not be as high as those obtained from the RAAF. The taxpayer submitted that the evidence in this appeal are similar to *West v Phillips* where the sale of the assets were held not to be in the nature of trade. In that case and in the present appeal, the sale was because they could not get the high rental. The cause of the rental depression may differ, but the motive for sale is the same, ie the prospect of poor future returns. See also *Lower Perak Co-operative Housing Society Bhd*.

The learned counsel for the taxpayer contended that since none of the badges of trade applies to the taxpayer, the sale of the 88 units of houses were not trading but disposal of capital assets.

[18] In dealing with this point, the learned judge in his judgment stated as follows:

> It is clear from the evidence before the Special Commissioners that these units of houses built on the subject land was for the purpose of renting them out to the RAAF. When the RAAF ceased renting them, the appellant did not want to rent them to the locals as the rentals to be paid was lower than that offered by the RAAF. It is the contention of the appellant that these houses were built for a particular purpose and from its point of view the construction of those houses was for purpose of investment as income tax was paid in respect of income earned from the rental received from the RAAF.
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> It is conceded by the appellant that the purpose of it purchasing the undeveloped subject land was for resale. Evidence enough is that from the various sales of the undeveloped portions of the subject land, tax was paid in respect of profits made. Also there is evidence even when houses were built on the subject land for purpose of their rental to the RAAF and when those houses were not actually rented by the RAAF, and when they were sold, tax was paid in respect of the profits made. This is the case of the seven units of houses constructed in Phase 1 together with the 75 others constructed for the RAAF. But when comes to those houses actually rented out to the RAAF but when no longer needed by the RAAF, and when they are sold, as in the case of the 88 units, the appellant says that tax should not be levied on the profits derived therefrom because they are built for purpose of investment. Income derived from the investment in the forms of rental incomes received from the RAAF had properly be taken care of by the appellant paying the tax due for them. In his submission the learned counsel for the appellant submits that after the RAAF vacated them the appellant could not get such good rentals from the locals as the RAAF were paying. Hence the necessity for their disposal — a disposal of the investment property. Various authorities both foreign and local were cited in support that the disposal of the 88 units was the realisation of an investment.
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> I think from the facts as found by the Special Commissioners the single case of *Simmons v Inland Revenue Commissioners* [1980] 2 All ER 798 will assist in resolving the issue as to whether the sale of the appellant's 88 units of houses built on the subject land is the realisation of its investment and therefore any profits derived from the transaction will not be subject to tax, or the disposal in the course of the appellant's business, which profits are subject to the payment of income tax. Lord Wilberforce at p 800 said:
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> > Trading requires an intention to trade, normally the question to be asked is whether this intention existed at the time of the acquisition of the asset. Was it acquired with the

> intention of disposing of it at a profit, or was it acquired as a permanent investment? Often it is necessary to ask further questions: a permanent investment may be sold in order to acquire another investment thought to be more satisfactory; that does not involve an operation of trade, whether the first investment is sold at a profit or at a loss. Intentions may be changed. What was first an investment may be put into the trading stock, and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax (cf *Sharkey (Inspector of Taxes) v Wernher* [1955] 3 All ER 493, [1956] AC 58). What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor for it to possess an inderterminate status, neither trading stock nor permanent asset. It must be one or the other, even though, and this seems to me legitimate and intelligible, the company, in whatever character it acquires the asset, may reserve the intention to change its character. To do so would, in fact, amount to little more than making explicit what is necessarily implicit in all commercial operations, namely that situations are open to review.

Intention of a person must be gathered from the surrounding circumstances. In 1956 when the subject land was purchased by the appellant, the dominant intentions was to sell it, of course at a profit. Thus the various sale transactions of portions of the still undeveloped subject land. Then the opportunity of making more profits came along the way with the coming of the RAAF to set up its base in Penang. It needed accomodation for the personnel. It is admitted that the RAAF was prepared to pay a higher rental than any local could. It was a good 'investment' for the appellant instead of selling out chunks of the undeveloped subject land, to construct houses on the unsold portions of it to be rented out to the RAAF. But the RAAF were not going to be there forever or to rent its houses forever. A time will come when they would cease to rent these houses of the appellant. What will happen then? If the intention of the appellant is true that the houses were built for investment purposes, those houses would be kept as an investment to be rented out to whoever else and to reap the rental income out of the investment. But this is not true because as the evidence before the Special Commissioners would show, the appellant was not prepared to rent them out any longer to persons other than the RAAF for the simple reason that these persons were not going to pay rental as high as the RAAF did. Immediately the appellant has to find market to sell these houses, of course at a profit. This it succeeded. So, in my view, under no stretch of imagination, can it be said that the construction of those units of houses on the subject land meant for sale, be construed as an investment by the appellant. The construction of the houses on the subject land, on the fact, cannot be taken to be a permanent investment. There is no evidence to suggest that the sale of the 88 units of houses by the appellant was for the purpose of acquiring another investment thought to be more satisfactory. The shifting of the position of the account of the appellant from fixed assets to current assets then back to fixed assets as found by the Special Commissioners from the evidence does not, in the circumstances, truly represent the shift in the intention of the appellant from business to investment. The decision of Sharma J in *NYF Realty Sdn Bhd v Comptroller of Inland Revenue* [1974] 1 MLJ 182 is also of help to resolve the issue. At p 183, his Lordship said:

> Most of the cases which have been decided on the subject have involved the application of the first of the above requirements (i.e. profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit making by sale). In determining the application of these requirements the focal point of enquiry is the dominant purpose for which the particular property was originally acquired. If it is established that the dominant purpose in the acquisition of property was its resale at a profit, the presence of other purposes, such as the rental of that property does not remove any profit on ultimate sale from the taxable area.

A The dominant purpose for which the subject land was originally acquired is clear, ie its resale at a profit. The construction of the houses on the yet unsold portion of the subject land was nothing but to enhance the value of that portions where the houses stood so that when that portions were to be sold later on when their immediate purpose for the construction is served, more profits could be derived. I share the view of Sharma J that the presence of other purposes, such as the rental of that property does not remove any profit on ultimate sale B from the taxable area. The situation faced by the appellant resulting in the sale of those 88 units were far different from that faced by Mr West in *West v Phillips* [1956-1960] 38 TC 203. He built class 'B' houses for the purpose of selling them and in 1933 he built class 'A' houses for investment purpose by renting them out to tenants. In 1947 he set up an estate agency business for the purpose, inter alia, of selling the class 'A' houses. As both his class 'A' and class 'B' houses became vacant he redecorated and made ready for sale and were C advertised for sale by his estate agency. The Commissioners found that Mr West has changed his intention in respect of his class 'A' houses from investment to trading. Wynn-Parry J of the High Court held that the mere circumstance that Mr. West dealt with the class 'A' and class 'B' houses together cannot reasonably lead to the conclusion that he was designing to alter or was altering the character of the class 'A' houses as investments. The fact in that case is that both classes of houses were rent controlled. But at the time of the construction of the D class 'A' houses Mr West estimated that the net yield from rents would be available year by year to meet the capital element in the building society repayments, gradually decreased and finally vanished. But during the war the cost of house repairs increased. He had to pay 30,000 pounds for war damage insurance. The standard rate of income tax and rates of surtax increased. By March 1956, he owed substantial arrears of income tax and surtax and he was also unable to meet the tax liability for the then current year. He arranged with the E Revenue to pay 2,000 pounds a month, but his net income from rents was inadequate to enable him to pay that monthly sum. All those happenings has made his class 'A' houses no longer a profitable investment. They produce no profits but was becoming a liability. On those finding of facts the learned judge overturned the finding of the Commissioner that the sale of class 'A' houses was in connection with his trade. But those circumstances are not found in the instant case. For that reason West v Phillips is easily distinguishable. F *H Mohamed & Co v Commissioner of Income Tax, Gujarat* [1977] 107 ITR 637 cited by the learned counsel for the appellant cannot be used on its facts to determine that the subject property was the capital asset of the appellant as opposed to his stock in trade. In that case, the assessee firm carries on business of hiring out furniture for marriage functions, circus shows and other public functions and derives income from this business. It was held that the assessee is not a dealer in furniture but hires out furniture for different functions. G Hence the furniture are the assessee's capital asset. At p 643, Divan J said:

> To put it in a proper compass, a stock-in-trade is something in which a trader or a businessman deals; whereas his capital asset is something with which he deals. It is possible that one and the same commodity may in the case of one assessee be this sotck-in-trade, whereas in the case of another assessee it may be his capital asset. H For example, in the case of an assessee who carries on the business of buying and selling land, land may be his stock-in-trade but in the case of an assessee who has invested his savings in land and gets income from the land or the structures put up on the land, the land is his capital asset.

At a first glance, the 88 units of houses built by the appellant on the subject land which is I its stock-in-trade, may appear to be its capital asset because with them it deals to get the rental income from the RAAF. But considering the example given by the learned judge of an assessee who has invested his savings in land and gets income from the land or the structures put up on the land, the land is his capital asset, it does not fit with the facts of the instant case of the appellant. The subject land on which the houses stood is not the appellant's capital asset. The appellant did not intend to invest its savings in the subject land

and got income from the land or the structures put up on the land so as to make the subject land its capital asset. The subject land remained its stock-in-trade and the houses were constructed on it purely to snap on the advantageous position of the rental to be paid by the RAAF and when the purpose was no longer served, the houses together with the acres of land on which they stood were disposed off. So, the houses with which it dealt cannot in the circumstances be regarded as the appellant's capital asset, they being transient in nature. In the circumstances, on the facts found and stated by the Special Commissioners, their decision to dismiss the appeal of the appellant in relation to the issue of the sale of the 88 units of houses built by the appellant on the subject land is correct in law.

[19] In my view, the learned judge had stated the issue in respect of the sale of the 88 units of houses correctly. He had analysed the facts in the present appeal in the most appropriate manner and correctly. I find that there was no error in his judgment in respect of the 88 houses. There is nothing much I could add to what have been said by the learned judge. The only thing I wish to add is the element of forced sale as in *West v Phillips* and *Lower Perak Co-operative Housing Society Bhd* cited by the taxpayer. In both cases cited by the taxpayer, it was in evidence that if the taxpayer kept those properties as stock in trade the taxpayer would suffer increasing losses from year to year. In the present appeal, the taxpayer failed to show that in keeping those houses for rental, the taxpayer would suffer losses. The taxpayer submitted that if those houses were kept for rental then the rental received from the locals would be less than the rental paid by the RAAF. In other words, if those houses were kept by them and rented out to the locals they did not generate as much income as they had been rented out to the RAAF. There was no evidence to show that the taxpayer had suffered losses when those houses were rented out to the locals. In *West v Phillips*, it was shown that the taxpayer suffered losses in maintaining those houses for rentals. For that reason, in the present appeal, I could not find any justification for the taxpayer to dispose of those houses. The element of forced sale was not present in the present appeal.

[20] As I have stated earlier, we have dismissed the appeal by the Revenue against the decision of the learned judge in respect of the compensation after hearing the submissions of both sides. The decision to dismiss the appeal was unanimous.

[21] We have indicated at the end of the trial that the issues in respect of the disposal of the 88 houses were more complicated and we needed time to consider them. After hearing the submissions of both sides and after perusing the appeal records, I am of the opinion that the appeal by the taxpayer should also be dismissed with costs.

[22] My learned brother, PS Gill FJ has seen my judgment in the draft and has agreed to the reasoning and the conclusion therein. My learned sister, Rahmah Hussain FJ has since retired and as such could not give her comments on the draft judgment and her decision in respect of the second appeal.

A **[23]** For the above reasons, the appeal by the taxpayer is also dismissed with costs. Since both appeals have been dismissed with costs, the deposits are to be paid to the account of taxed costs of each party.

Appeals dismissed.

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Reported by Loo Lai Mee

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